Potential Changes to Prior Approval Regulations for Property/Casualty Insurers Under Consideration by California Department of Insurance

November 18, 2011 by **Robert W. Hogeboom**, **Samuel Sorich** and **Steven Weinstein**

On November 10, 2011, the California Department of Insurance ("CDI" or "Department") conducted a workshop to consider potential changes to regulations that govern prior approval of property/casualty insurance rates and class plan applications. The list of topics discussed at the workshop is included in the CDI Notice of Workshop Regarding the Scope of Prior Approval dated September 21, 2011.

The workshop grew out of the 2010 *MacKay v. Superior Court* case in which the court held, among other things, that Insurance Code Section 1860.1 exempts approved rates from civil actions and that such rates are subject only to a limited prospective challenge by administrative procedure (under Insurance Code Section 1858 et seq.).

Barger & Wolen was counsel for the prevailing insurer, 21st Century Insurance Company, in *MacKay*, and our two blogs on the *MacKay* case can be accessed here and here.

MacKay involved 21st Century's use of the accident verification factor which plaintiffs asserted was not an approved rating factor, but only an unapproved underwriting guideline.

The court concluded that the "language submitted to the Department for approval" is what is relevant as to whether a guideline is "submitted to the Department as a factor affecting the rates to be charged."

Here, though accident verification was contained as an underwriting guideline, the insurer explained the use of accident verification in an exhibit to its rate application as affecting the rates to be charged and had been approved by the Department.

Based on *MacKay*, the use of underwriting guidelines was a prominent issue in the workshop.

Heading the workshop from the CDI were General Counsel Adam Cole, Joel Laucher, Chief Deputy of Rate Regulation, and Bryant Henley, Senior Counsel for the Rate Enforcement Bureau.

While there was an exchange of views among insurer representatives, representatives of consumer groups and the CDI staff, no decisions were made at the workshop.

Mr. Cole announced that interested parties have until December 1, 2011, to submit written comments on the workshop topics.

At that point, the CDI presumably will review the workshop record and determine whether to propose any new regulations relating to the workshop topics.

Following is a summary of the key issues discussed at the workshop:

1. Whether the terms rating factor, rate, and premium needed to be clarified in order to ensure that every item that makes up the rate is properly disclosed and reviewed by the CDI.

This issue focused primarily on underwriting rules in which a specific rule, such as a "surcharge" or "coverage," is included in the rate and reviewed by the CDI during rate review.

The CDI asserts that the goal of the CDI is to assume that the consumer and the insurer can rely on the approval.

The CDI raised the issue whether an underwriting rule should be considered a rating factor.

The industry asserts that the terms relating to rate and premium etc. are all well settled by the courts. Further, the industry submits that the rate application process is thoroughly vetted by the CDI, which routinely seeks further information or explanation on all issues that are relevant to the rate application determination.

Consumer Watchdog announced its skepticism that not all factors that make up the rate are always properly disclosed or reviewed by the CDI. It called for new regulations that would assign narrow definitions to the terms "rating factor," "rate," and "underwriting guideline."

In the context of private passenger auto insurance, Consumer Watchdog argued that "rating factor" should mean only the three mandatory factors and the optional rating factors specified in regulations adopted by the insurance commissioner and should not include discounts or surcharges.

Consumer Watchdog advocates a further regulation be adopted to the effect that any price variation from the rating factors is a violation of the statute and that discounts not be allowed.

Barger & Wolen's Steven Weinstein, and other insurers' representatives, pointed out that regulatory section 2632.2(a), which defines "rating factor" as any factor which "establishes or affects the rates, premiums, or charges assessed for a policy of automobile insurance," provides good guidance.

Weinstein cautioned against narrow definitions that would make the prior approval process inflexible, and which in turn would hurt market competition. Weinstein added that there was no evidence to support the necessity for such changes, and that the CDI indicated that certain underwriting rules, such as surcharges, could affect the rate.

2. If underwriting rules contain rules which affect the rate, should the underwriting rules be subject to public disclosure and/or prior approval?

Currently, the Department often requests that certain underwriting rules which contain an insurer's eligibility guidelines are required to be filed as a supporting document to the rate application. In many cases, they are deemed confidential per request of the insurer as proprietary information. The CDI expressed the view that underwriting rules, to the extent they impact the rate, should be made available for public inspection.

Consumer Watchdog argues that Insurance Code Section 1861.07, which provides that all information provided to the commissioner pursuant to the Insurance Code provisions regarding prior approval be made available for public inspection, requires disclosure of underwriting guidelines.

Insurer representatives responded that underwriting guidelines contain trade secrets that have legal protection and that section 1861.07 should not be read that broadly.

An insurer representative described the research and expense that is involved in developing underwriting guidelines. An insurer will not make this kind of investment if its guidelines are made available to the insurer's competitors.

The disclosure of underwriting guidelines would have devastating effects on insurance competitiveness.

3. What is the effect of a rate approval in which it was based on a rate application that contained an unlawful factor/underwriting rule?

Insurer representatives asserted that the rate application and prior approval process provides full disclosure of an insurer's proposed rates and class plans. The CDI's job is to review and rule on the insurer's changes.

Once the CDI approves the insurer's changes, the insurer must be able to rely on the CDI's approval.

In fact, Insurance Code Section 1861.01(c) prohibits an insurer from charging a rate that has not been preapproved by the CDI.

Mr. Weinstein reminded the CDI of the California Court of Appeal's ruling in *MacKay v. Superior Court* which held that if an approved rate is subsequently found to have been illegal, that finding cannot retroactively invalidate the CDI's prior approval.

Consumer Watchdog argued that the CDI does not have the authority to approve an illegal rate, and that the Department's approval of an illegal rate is a nullity and beyond the scope of the CDI's power.

Consumer Watchdog furthered argued that the CDI's authority over rate approvals is not exclusive. It asserted that Proposition 103 requires the CDI to share that authority with consumer representatives.

4. Whether the CDI Should Adopt Procedures for Handling Referrals from Courts

This topic was outlined by the Department's Adam Cole.

Mr. Cole explained that there is some confusion about how the CDI should handle cases in which the courts refer to the CDI pursuant to the primary jurisdiction doctrine. Mr. Cole asked whether there is a need for new regulations which would describe how the procedure for handling primary jurisdiction cases differs from the procedure for addressing complaints that are filed under Insurance Code Section 1858. Neither insurer representatives nor consumer representatives expressed support for adoption of regulations on this matter.

5. Additional Topic Raised by Consumer Watchdog – Actions that Constitute Approvals

Consumer Watchdog raised a topic that was not included in the workshop notice. Consumer Watchdog argued that the *MacKay* decision relied on statements from CDI staff to establish that a filing was approved. They called on the CDI to create a system that defines what actions by the CDI staff may be deemed to be "approvals."

Insurer representatives rejected Consumer Watchdog's proposal. They pointed out that the proposal would destroy necessary communication between CDI staff and insurers that enables insurers to gain regulatory certainty which results in actions that deliver products and services to consumers. Subjecting this ongoing communication to a formal process for determining the nature of each communication would put insurers and CDI staff into a regulatory straightjacket that would prevent things from getting done.